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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

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THE MARKET This writer trades Services and correspondence with perhaps twenty leading investment organizations. I have been studying this week's mailings with particular care. There is little questions but that they are almost unanimously bullish. Among the opinions and views most frequently expressed are: (1) The technical position of the market (despite the extended rise) remains unusually strong, and new highs for the Averages are "only a matter of time". (2) The public is still absent, but they will return as soon as the Industrials better their all-time (734.91) high. (3) The market rise is discounting monetary inflation and/or devaluation -- therefore it is useless to attempt to "explain" the move in terms of economic fundamentals. (4) Despite possible near-term uncertainty, the long-term picture is highly bullish. Following what may be short-term uncertainty, the market should embark on a major rise to or above the 800 level.

Against the bullish professional view, the public remains monumentally disinterested. The ratio of odd-lot to total N. Y. S. E. transactions is currently running at around 7.5%, a record low. Brokers tell me that when they call prospective "small investors", they are told that "I have no time" or "I'd rather put it in my own business or in the bank."

Hamilton once said that he had never known the majority of professional opinion to be correct. Could it be that we are going into a period wherein everybody (professionals and public) will be wrong? What could such an event be? I have never felt so strongly that the period ahead will be a dramatic one. The market seems poised for something "big".

Personally, I have a few guesses of my own regarding the forthcoming picture. They are: (1) The near-term picture is all right, but the long-term is not. (2) There is a good chance that the public will not come into this market at all, regardless of new highs. (3) The current rise will terminate with the advent of a news event (perhaps a tax cut or even devaluation) much as the 1959-60 rise ended with the news of the steel strike settlement.

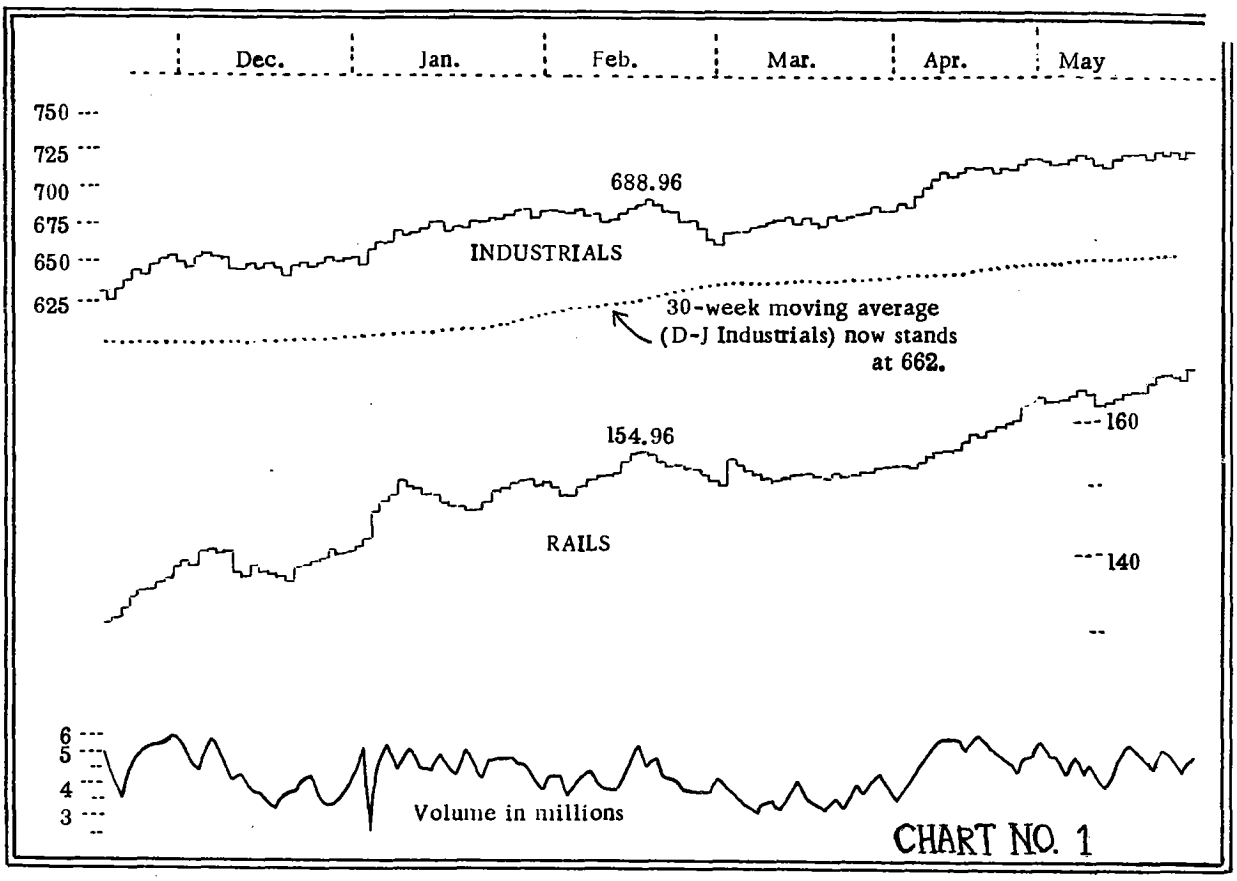


CHART NO. 1

There is certainly no denying that the market has kept the bulls smiling. By the end of last week, in fact, the Industrial Average had established a remarkable record. As of Friday (May 17), Industrials had closed higher for eleven consecutive weeks. To

my knowledge, this is a record which is unmatched in the sixty-three year history of the Averages (the explosive year 1958 produced only nine consecutive weeks of Industrial advance).

Can a market which produces such a record be considered anything but strong? It would be hard to believe otherwise. Nevertheless, as stated in the last Letter, this market continues to be a "frustrating" affair. The advance has not (so far)possessed the broad sweep of 1953-55, 1958-59 or even 1960-61, and there remains a mass of stocks which have not been able to move substantially from their 1962 lows.

From the near-term viewpoint, the picture continues to be a strong one. On May 21, following minor weakness, Industrials closed within a fraction of their May 15 (724. 34) recovery high, Rails closed at a new recovery high of 169. 39, and the A-D ratio closed just fractionally under its own May 15 high. Volume continues to expand with higher prices and contract on declines. Until these indications change, the trend must be considered up.

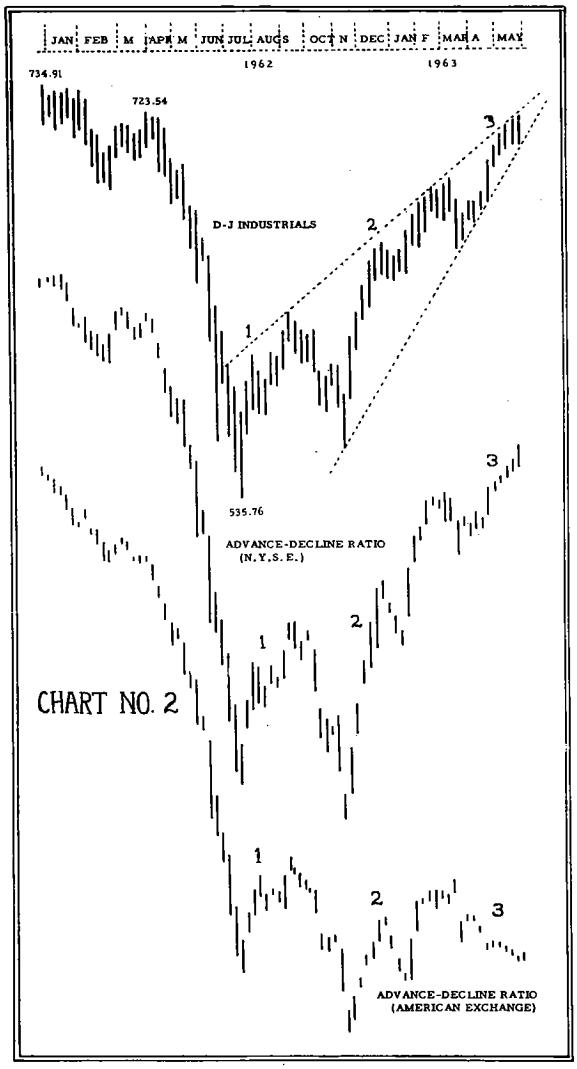


CHART NO. 2

STRANGE PERFORMANCE I have written a good deal lately about the strange lack of speculative sentiment during the 1962-63 rise. The situation assumes an almost dramatic aspect when we compare the powerful weekly movements of the high-grade D-J Industrial Average, the advance-decline ratio on the New York Stock Exchange and the lagging advance-decline ratio on the American Exchange (see chart No. 2).

The rise since June, 1962, has taken the form of three upward thrusts. The first (marked 1 on chart) was accompanied by broad participation on both Exchanges. A reaction followed during which both A-D ratios broke to new lows -- unconfirmed by the D-J Industrial Average.

The second thrust began in October, 1962 (2 on chart) and terminated in February, 1963. The second thrust was accompanied by excellent breadth on the N. Y. S. E., but on this move the American A-D ratio failed to better its August peak. Obviously, the secondary issues as represented by the American A-D ratio were failing to participate fully in the move.

The third thrust began towards the end of February. Here the Industrial Average rose to new recovery highs, and the A-D ratio on the N. Y. S. E. confirmed by advancing to recovery highs. A strange element of the third thrust, however, was the divergent sag of the A-D ratio on the American Exchange. As seen on the chart, since February, 1963, the trend of the majority of stocks on the junior Exchange has been down.

My own interpretation of this phenomenon is as follows: I do not believe that the divergence between the American and the rest of the market can continue. I feel that a resumption of the downward trend on the American will mean a broad consolidation or downward reversal in the rest of the market. Conversely, a concentrated rise in the American A-D ratio (above its February peak) would suggest that the general market was turning highly speculative for the first time since the rise began in June, 1962.

PATTERN OF THE RISE As seen on the accompanying chart (chart No. 2), the rise in the Industrial Average continues to assume the form of a giant "rising wedge". This concept was discussed in Letter 213, and the advance since then has not altered the situation.

By orthodox definition, a rising wedge pattern denotes a situation in which buying interest is steadily diminishing as prices rise. For this reason, volume almost always diminishes as a rising wedge progresses. Yet this has not been the case in the present structure. Since October, 1962, there has been a tendency for volume to expand as the market advanced. Moreover, it would be difficult to say that buying interest diminished as the advance progressed (although buying interest has not broadened greatly either).

These Letters have drawn attention to many technical "danger signals", such as broadening formations and rising wedges in individual stocks, failure of daily new highs to expand as the rise progresses, refusal of the American Exchange to enter into the move. Nevertheless, a market that can push persistently higher while sweeping all such technical "weakness" aside, possesses an undeniable strength of its own. In the past, such strength has frequently been associated with post-crash

periods. Thus the tremendous year-long strength of 1908 followed the "Panic of 1907". The almost vertical rise of mid-1938 followed the 1937 and early 1938 collapse. And the 1930 explosion came subsequent to the 1929 debacle. On other occasions the market has made extraordinary progress in anticipation of some dramatic news event. For instance, following the Bank Holiday of March, 1933, the Averages recorded one of their greatest rises on record in anticipation of a rise in the price of gold (one wonders if history is repeating).

The last Letter (218) dealt with the possiblity of a great "blow-off" in the market. The Industrials are now within 2% of their 1961 all-time high and the total short position on the N.Y.S.E. is now 5.8 million shares. My own opinion is that if Industrials can better their old high of 734.91 in the near future, such action together with the "trapping" of 5.8 million shorts could supply the spark for a rousing climax to the advance.

Conversely, if the market should turn down from this area after failing to better the 734.91 high, we will have to watch the "quality" of the decline carefully. The penetration of the 1961 Industrial high has been one of the best-advertised "events before the event" that this writer has ever encountered. From all reports, it will occur in a matter of days or a few weeks. But I want to see it, not hear about it.

A study of a weekly or monthly chart of the Averages will demonstrate the following interesting phenomenon: each successive major advance in Industrials since 1949 has been progressively steeper. Furthermore, each successive decline since 1949 (i.e., 1953, 1957, 1962) has been sharper and more drastic. It is not illogical, then, to expect that the turn and descent from whatever highs are established on the current rise will be swift and unexpected.

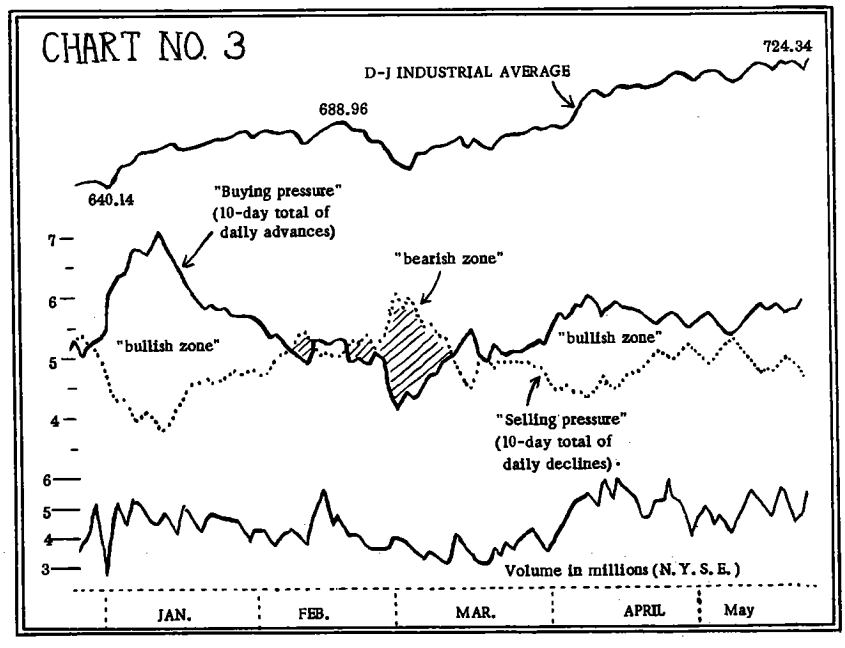
What does this mean in terms of market policy for the long-term investor -- for the trader? For the long-term investor I feel that the current rise should be accepted as a continuing opportunity to unload any and all stocks which were not liquidated during the past few years. Those who attempted to sell during 1962 will remember how difficult it was to find bidders in that liquidating market. For the trader, I feel that the current move presents the possibility of a speculative "wind-up" with investment interest spreading into secondary issues. Preceding Letters have discussed many stocks, but I feel that all such purchases should be treated as pure speculations -- executed with the understanding that this market rise could terminate with an almost vertical spurt -- then reverse with little or no warning.

BUYING AND SELLING PRESSURE The buying pressure line crossed above the selling line on February 19. It has held that bullish position for 44 consecutive days. On May 7 (see chart No. 3) the two lines almost touched, but since then buying pressure has again risen while selling has declined.

It is rather strange that the buying line does not rise to new highs for the move or that selling does not really subside. The closeness of the two lines plus the continuing high level of daily volume suggests a certain amount of "churning". Nevertheless, the longer the two lines maintain their current bullish relationship, the better the odds for a major upward move. Optimists are claiming that the market is now "chewing into the major supply" of stock which exists just under the all-time highs. If true, this may account for the churning appearance of the buying-selling lines and volume.

If we are to go through the highs, I would expect the two lines to flair apart, with buying, of course, remaining the dominant line. If the lines cross (with selling dominant), we will have received the signal for trouble ahead (the more so if such a crossing takes place prior to a new Industrial high).

NOTE What Dow actually said is seldom seen by investors. Seventeen of Dow's original Wall Street Journal editorials on speculation were reprinted in 1903 by S. A. Nelson in a book entitled "The A.B.C. of Stock Speculation". My friends at Merrill Analysis, Chappaqua, New York have reprinted the original seventeen chapters in a loose-leaf book. It's a beautiful printing job, it's a rare work, and it's well worth having. I have agreed to handle this book, price $4.50 postpaid (please send check).



STOCKS Of 420 stocks (we have raised the number) which are tabulated here each week, 320 or 76% are now holding above their 30-week moving average (an increase of 4% from last week).

Letter 217 drew attention to the large "inverse head-and-shoulder" pattern in Blaw-Know. The stock "broke out" above its resistance (dotted line on chart), and since then has "pulled back" on diminishing volume. BK strikes me as being one of the better speculations at this time.

U. S. Borax and Chemical (chart below) has also formed a large "head-and-shoulders bottom" and the stock has recently pushed out of its extended base. UBX and BK both qualify as "buys" for speculative purposes. Note also that the relative strength lines for both of these stocks have reversed long downward trends (relative strength is computed as a ratio of the price of the individual stock and the S & P "500" Stock Average).

I have included weekly charts covering five years of action in two leading blue-chips, Alcoa and General Motors. The comparisons of these two issues are most interesting. GM seemed to have "topped out" in 1959. But the stock formed a long "rounding bottom" during 1960 and 1961. Following a rather violent "shakeout" in 1962, GM turned up and catapulted into all-time high ground. Note that the big 1962-63 move came following a base which was actually two years long (1960-61).

Alcoa also topped in 1959, but this stock like many others never really recovered from its long decline. Nevertheless, the long descending trendline which has held in effect since 1959 has recently been penetrated. As such AA would seem to be a good speculation for a continuation of the current reversal to the upside.

Charts of UBX and BK courtesy of Traders Research, P.O. Box 2466 , St. Louis 16, Missouri.

Charts of AA and GM courtesy of Quote Digest, 110 North Lorraine, Wichita, Kansas.